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REF: A. KATHMANDU 2555

1B. 04 KATHMANDU 1878
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Classified By: CDA Elisabeth I. Millard, reasons 1.4 (b/d)

WORLD BANK LOAN IN JEOPARDY?

11. (SBU) His Majesty's Government of Nepal (HMGN) has failed to meet four critical commitments on economic reform that it promised the World Bank by the end of November 2005, putting the status of the USD 100 million Poverty Reduction Strategy Credit II (PRSC II) loan in jeopardy. The four conditions agreed to in a meeting between the Bank and HMGN officials in Washington in September were: seize the passports of top loan defaulters and suspend ownership transfer of fixed assets of those defaulters who failed to reach amicable settlements with their lending banks; enforce the Governance Act, which would give more authority to local government units to carry out development work; enforce the Labor Act, which would give industry more power to hire and fire employees and make Nepal more investment friendly; and implement an automatic market-based pricing mechanism for petroleum, which would correct HMGN's losses on petroleum subsidies (ref A).

HMGN MAY BE TAKING ACTION SOON

12. (C) Rameshwor Prasad Khanal, Joint Secretary, Foreign Aid Division, Ministry of Finance, told EmbOff that "HMGN had no doubt failed to fulfill the promises it had made to the World Bank on economic reform measures on four critical issues, however, the PRSC II loan had not been suspended yet." He added, "that draft legislation related to the four commitments are in the final stage of approval by the cabinet and would likely be approved as ordinances by the end of this week." In contrast, Shankar Sharma, Vice-Chairman of the National Planning Commission, has recently confidentially expressed concern to some international donors about the lack of political will to meet the four conditions.

WORLD BANK STILL OPTIMISTIC

¶3. (C) Rajib Upadhyaya, Senior External Affairs Specialist, World Bank, stated that it was the Minister of Finance who gave the Bank the end of November deadline, and that the four conditions would remain in place until HMGN complied with all of them. He said the Bank had rejected a past proposal from HMGN in which HMGN would enforce the Governance and Labor Acts to get half of the loan amount. He stressed that the Bank was most concerned about HMGN pursuing willful defaulters (ref B). Upadhyaya said that of the four conditions, the Bank was least concerned about the Labor Act. He outlined that it would take the Bank three to four months to process the loan after all conditions had been met. In the previous fiscal year, the Bank had given HMGN a February 15 compliance deadline and then the royal takeover stalled all progress until the Bank's annual meetings in Washington in September 2005. He commented that if HMGN's non-compliance continued, the most probable scenario would be for the Bank to give HMGN another late February deadline. If HMGN met that deadline, the Bank would be able to process the loan by the end of the Nepali fiscal year, July 15, 2006. Further, he said HMGN had budgeted USD 35 million for PRSC II for the 2005-2006 fiscal year and that non-compliance within the fiscal year would leave HMGN with a budget shortfall of that amount.

COMMENT

¶4. (C) Post is not optimistic HMGN has the political will to carry out the four economic reform conditions, particularly dealing with willful defaulters. Though Vice-Chairman Giri is no longer on the willful defaulters list (ref C), a number of wealthy/influential Nepali businessmen are.

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